CONTENTS

	Page
OVERVIEW	17
CHAPTER 1. THE YEAR IN REVIEW AND THE YEARS AHEAD	25
Developments in 2007 and the Near-Term Outlook	27
Consumer Spending and Saving	27
Housing Prices	29
Residential Investment	30
Business Fixed Investment	32
Business Inventories	34
Government Purchases	34
Exports and Imports	35
Employment	37
Productivity	38
Prices and Wages	40
Financial Markets	42
The Long-Term Outlook Through 2013	43
Growth in GDP over the Long Term	43
The Composition of Income over the Long Term	47
Conclusion	48
CHAPTER 2. CREDIT AND HOUSING MARKETS	51
What are Credit Markets?	52
Recent Developments in Mortgage Markets	53
Credit Market Disruptions in 2007	61
Credit Market Link to Mortgages	61
Flight to Quality	62
Contraction of the Asset-Backed Commercial Paper Market	64
Slower Merger and Acquisition Activity	65
Equity Markets	66
International Implications	67
Policy Response to Credit Market Disruptions	67
Policy Response to Housing Market Challenges	68
Addressing Current Challenges	68
Strengthening the Mortgage Market for the Future	71
Macroeconomic Implications	74
Conclusion	76

CHAPTER 3. THE CAUSES AND CONSEQUENCES OF EXPORT GROWTH 79
The Causes of Recent Export Growth 80
Foreign Income Growth 83
Growth in Domestic Production 86
Exchange Rates 86
Trade Costs and Barriers 86
Exports and Foreign Direct Investment 88
Multinationals and Trade 90
The Benefits of Trade and Expanding Export Markets 91
Trade and Labor Markets 93
Conclusion 95

CHAPTER 4. THE IMPORTANCE OF HEALTH AND HEALTH CARE 97
Health and the Demand for Health Care 98
Demand for Health 98
The Production of Health 98
Trends in Health Spending 100
Trends in Life Expectancy 101
Trends in Health Insurance Coverage 103
Addressing Challenges in the Health Care System 104
Moral Hazard and Cost Control 106
Controlling Costs Through Competitive Insurance Markets 110
Improving Quality and Costs Through Information and Reimbursement 111
Promoting Healthy Behavior 113
Conclusion 114

CHAPTER 5. TAX POLICY 115
The Size of Government: A Historical View 116
Expiration of the 2001 and 2003 Tax Cuts 118
Alternative Minimum Tax 119
Real Bracket Creep 119
Withdrawals from Tax-Deferred Accounts 120
The Impact of Recent Tax Reductions 121
Labor Supply 122
Saving and Investment 123
Corporate Financial Policy and Governance 125
Significance of Tax Cuts to Individuals 127
Economic Benefits of Lower Taxes 128
The Structure of Business Taxes 131
Conclusion 136

CHAPTER 6. THE NATION'S INFRASTRUCTURE 137
The Basic Challenge of Infrastructure Policy 138
Current State of the Nation's Infrastructure 140
Roads 140
Bridges 145
Railways 146
Container Ports 148
Aviation 149
The Electrical Grid 152
Telecommunications 154
Infrastructure Policy 157
How Should Infrastructure Be Paid For? 158
How Should Government Set Priorities for Infrastructure Projects? 158
When Should the Government Regulate or Provide Infrastructure? 159
What Are the Proper Roles for State and Federal Government? 161
Conclusion 162

CHAPTER 7. SEARCHING FOR ALTERNATIVE ENERGY SOLUTIONS 163
Energy Sources 164
Fossil Fuels 165
The Need To Diversify 168
Alternative Energy Production 170
Alternatives for Generating Electricity 170
Alternatives for Transportation 177
The Road Forward 182
Policy Tools 183
Current Efforts 184
Conclusion 185

CHAPTER 8. IMPROVING ECONOMIC STATISTICS 187
An Overview of the U.S. Statistical System 188
The Importance of Statistical Systems 192
Keeping Up with a Changing Economy 193
Improving the Value of Existing Statistical Data 196
Conclusion 202

APPENDIXES

A. Report to the President on the Activities of the Council of Economic Advisers During 2007 203
B. Statistical Tables Relating to Income, Employment, and Production 217

LIST OF TABLES

1-1. Administration Economic Forecast 44
1-2. Supply-Side Components of Real GDP Growth, 1953-2013 45
4-1. Additional Life-Years Due to Reduced Mortality from Selected Causes, for US by Decade, 1950-2000 (years) 102
5-1. Comparing the Marginal Tax Rate for a Career Changer Under Two Illustrative Tax Policies 123
5-2. Estimated Distributional Effects of 2001-2006 Tax Cuts in 2007 127
5-3. Effective Marginal Tax Rates on Investment 132
7-1. Estimated Average Levelized Costs (2006 $/megawatthour) for Plants Entering Service in 2015 171

LIST OF CHARTS

1-1. Consumption and Net Worth Relative to Disposable Personal Income (DPI) 28
1-2. Net Debt Issuance 33
1-3 Output per Hour in the Nonfarm Business Sector 39
1-4. Consumer Price Inflation 40
2-1. Percent of Mortgages 90 Days Past Due or In the Process of Foreclosure 57
2-2. Conforming and Jumbo Mortgage Rates, 30-Year Fixed Rate Mortgages 60
2-3. Three-month London Interbank Offered Rate and Rates on 3-Month Treasury Bills 62
2-4. Spread Between Corporate Bond Yields and Rates on 10-Year Treasury Notes 63
2-5. Commercial Paper Outstanding 65
2-6. Value of Announced Merger and Acquisition Deals 66
2-7. Monthly FHA Mortgage Endorsements 73
2-8. Lending Standards 75
3-1. U.S. Exports As a Share of Gross Domestic Product 80
3-2. Average Annualized Growth in U.S. Exports to Trading Partners, 2003-2006 81
3-3. Real Growth in U.S. Exports and Foreign Gross Domestic Product 85

3-4. Growth of U.S. Goods Exports to Free Trade Agreement Partners, 2005-2006 88
3-5. Imports and the Unemployment Rate, 1960-2006 94
4-1. National Health Expenditures As a Share of Gross Domestic Product 100
4-2. Life Expectancy at Birth and at Age 65 101
4-3. Health Insurance Coverage by Source: 1987 to 2006 103
5-1. Federal Receipts 117
5-2. Federal Receipts Projections 118
5-3. Real Personal Dividend Income 127
5-4. Federal Outlays Projections 130
6-1. Vehicle Miles Traveled and Lane-Miles of Road in U.S., 1980-2005 142
6-2. Annual Delay per Peak-Period Traveler, by Urban Area Size, 1982-2005 143
6-3. Condition of U.S. Highway Bridges, 1992-2006 145
6-4. Distribution of U.S. Freight Shipments by Mode 147
6-5. Container Trade at U.S. Marine Ports 148
6-6. Average Travel Time, New York (LGA) to Atlanta (ATL) 1988-2006 150
6-7. High-Speed Internet Lines in the United States by Type of Connection, 1999-2006 155
6-8. Wireless Communications Infrastructure in the U.S., 1985-2007 157
7-1. U.S. Energy Consumption and Production (2006) 166
7-2. U.S. Energy Consumption by Source and Sector (2006) 166
7-3. U.S. CO_2 emissions from Energy Consumption (2006) 169
8-1. Budget Authority for Principal Statistical Agencies, Fiscal Year 2007 189
8-2. Real Federal Appropriations for Economic Statistics 190
8-3. Federal Statistical Appropriations for 5- and 10- Year Censuses 191

LIST OF BOXES

1-1. Indirect Effects of the Housing Sector 30
1-2. Macroeconomic Effects When Oil Price Increases Are Induced by Foreign Demand 36
1-3. Aging and the Pattern of Labor Force Participation 45
2-1. Definitions of Select Mortgage Terms 54
2-2. Credit Rating Agencies 56
2-3. Geographic Variations in Housing Markets 58
2-4. Securitization and Structured Finance 60

2-5. Mortgage Lending Today 69
3-1. Trade in Services 82
3-2. The Current Account Deficit 84
3-3. Open Investment and the United States 89
4-1. Health Effects on Job Productivity 99
4-2. Government Health Care Programs 104
5-1. Marriage Penalty Basics 129
5-2. Expensing versus Corporate Rate Reductions 133
6-1. The Interstate Highway System 141
6-2. Delays at New York City Airports 151
7-1. Oil Prices 167
7-2. The Blend Wall 179
8-1. How to Reverse a Decline in Statistical Infrastructure: Improving the Sample for the Consumer Price Index 197
8-2. The Confidential Information Protection and Statistical Efficiency Act (CIPSEA) 199

FEB

2008